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Dear Andy

### **Ofgem's Five Year Strategy 2010-2015**

I am pleased to respond to the letter dated 28 July 2009 from Lord Mogg seeking views on the future strategy and priorities of Ofgem as part of the development of the next five year strategy for 2010-2015.

This period will be one of the most important in Ofgem's history. It is going to have a key role in developing the stable, long term regulatory, market and policy framework that will ensure security of energy supply is maintained and the significant investment in infrastructure required to meet the UK's energy policy objectives is supported. However, in doing so, it also has to be recognised that a number of policy interventions have been and continue to be made by government to achieve particular targeted social and environmental objectives. In this context, it is clear that Ofgem has a vital role to play in assessing the extent to which the current market will deliver a sustainable, low carbon energy supply system – particularly over the period 2010-2015.

With this in mind, we welcome the recent announcement by Ofgem setting out the extensive restructuring of its organisation. Ofgem's statutory duties have continued to evolve over recent years, with particular emphasis now being placed on sustainability. Consequently, the reorganisation should assist Ofgem in its important role of helping promote and deliver the government's objectives in moving to a low carbon economy.

Within the UK energy markets there is currently an extensive and almost unprecedented regulatory agenda over the short to medium term, with many significant and challenging energy issues to be addressed by Ofgem, government and industry. These include such important issues as (in no particular order): fuel poverty and the affordability of energy for consumers, security of supply, the competitiveness of UK industry, sustainable development, the shift to low carbon heating and transport, the renewal of the UK's ageing energy infrastructure, future regulation of networks, the roll-out of smart meters, development of smart grids, the development of the offshore transmission regime, the integration of the GB and EU markets, GB wholesale market liquidity, and code governance issues. Clearly all of these will feature prominently and need to be integrated and appropriately prioritised by Ofgem during the development of its next five year plan. It seems to us that the key for Ofgem, within the next five year period, is the need to strike the right balance in future between the promotion of competition and the promotion of other objectives, most notably sustainability and security of supply by other means. This will include the need for more considered interaction and integration of its own regulatory proposals and initiatives with the government's overriding energy policy objectives.

However, in this response, rather than trying to comment on all the many issues above, we would like to focus on your work in respect of a particular high priority regulatory issue, namely Project Discovery. As we understand it, this is looking at the development and security of Britain's energy markets and infrastructure over the medium-longer term and the ability of them to facilitate and manage the transition to a low carbon economy. We believe this will be a vital part of Ofgem's work over the next 1-2 years in particular.

### Project Discovery

We are entering a new phase in the development of the GB market and the transmission system, and this will require a new approach. Until recently, a relatively short term planning horizon (e.g. 7 year statement timeframe) and a policy of 'invest and connect' has served the market well in the relatively stable circumstances that have prevailed, with healthy system plant margins, more than adequate grid capacity, and where market and plant changes have generally been incremental. However, that is not the case now, nor will it be in the future. Plant margins are being challenged, the transmission system is in need of significant reinforcement and the predominant type of plant is going to have to fundamentally change, with traditional fossil fuelled, carbon intensive thermal technologies being progressively replaced by new low carbon generation, to meet binding targets for reductions in CO<sub>2</sub> emissions. In this new world, the development of new regulatory policies, together with much longer term planning and strategic grid investment, is required to deliver the most efficient, affordable and secure route to meeting both our customers' energy needs and government policy objectives.

Ofgem has a vital role to play in informing and steering the debate on the appropriate investment in the transmission system and the associated market structure required for the different potential pathways that could be followed to meet the UK climate change targets over various timescales. A key role of Project Discovery will be to ensure that competitive markets remain and that a stable, long term regulatory and policy framework is developed that will ensure security of energy supply and support the significant investment in the infrastructure (in grid, interconnectors, gas storage and low carbon generation) required to meet the UK's energy policy objectives.

As regulator of the energy markets and of the GB SO and the TO in England and Wales, Ofgem has a vital role to play in informing the debate on the development of the market and the appropriate investment in the transmission system required for the different potential pathways that could be followed to meet the UK climate change targets over various timescales. To that end, the work which National Grid and the ENSG has carried out to date, looking towards 2020, has been a necessary and valuable start. However, as government has recognised, a 2020 planning horizon is too short to determine the most efficient, affordable and secure longer-term route to delivering the major changes required to de-carbonise our energy systems. The work which has been flagged in the Low Carbon Transition Plan to produce a 'roadmap' to 2050 (to be delivered in Spring 2010) will be hugely important in determining the future strategic shape of the electricity and gas markets and transmission systems as a whole and thereby the best outcome for current and future customers. Ofgem's Project Discovery will be important in helping pull these various workstreams together.

With its responsibility for ensuring an economic and efficiently operated transmission network, Ofgem has to develop appropriate regulatory arrangements that manage the delicate balance of ensuring that new generation projects can be connected to the grid

and that the necessary grid reinforcements are in place in a timely manner so that the power generated can reach customers. In this context, the initial work done by the ENSG has been extremely useful in identifying some critical projects and associated issues, and also endorsing an incremental 'least regrets' approach to the necessary investment. It is important that the preparatory actions identified in the ENSG Report are carried out urgently to prepare for the longer term strategic investments that may be necessary. To that end we welcome Ofgem's decision to allow the TOs to fund preparatory work for this. We also note your recent consultation on Enhanced TO Incentives and would urge you to ensure that the TOs can recover the costs of this essential initial 'least regrets' infrastructure work.

The future role of distribution networks and Distribution Network Operators (DNOs) should also be explored as part of Discovery, in particular the extent to which 'smart grid' operation in conjunction with smart meters might capitalise on the potential for demand side participation to contribute to system balancing. The output from the recently formed ENSG Smart Grids Project Working Group (due to report by the end of this year) will complement the ENSG 2020 Vision Report and should be particularly informative in this respect.

EDF Energy therefore believes that in considering the most appropriate market framework and how NG must operate the transmission system in 2020 and beyond, and taking into account a range of potential plant mixes and locations, NG, Ofgem, DECC and the industry must urgently consider other scenarios beyond NG's single 'Gone Green' scenario. Ofgem should build on this work and, as a matter of priority, develop and publish alternative scenarios as part of Project Discovery that are consistent with, for example, the latest illustrative plant mix set out within the Low Carbon Transition Plan, the Renewable Energy Strategy of July 2009, and with all known thermal projects that are now in the pipeline. The scenarios will inform the wider debate on the most efficient, affordable and secure longer-term route to delivering the major changes required to de-carbonise our energy systems.

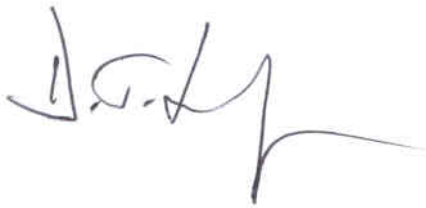
Between June and August 2009, EDF Energy commissioned Pöyry Energy Consulting to develop a number of future low carbon generation mix scenarios. All of the scenarios were designed to deliver a very large reduction in carbon emissions by 2030, and maintain the level of security of supply we enjoy today. Depending on the scenario adopted, total investment costs vary significantly. The most expensive scenario was one that included high levels of intermittent generation, where many major transmission upgrades were required, including investment to accommodate almost double the current peak flows between Scotland and England. Electricity transmission investment requirements in this scenario are three times that required in a scenario with lower levels of intermittent generation. This is why we believe that analysis should be undertaken on different scenarios and we would be very pleased to discuss this work with you in further detail. It is vital that the 2050 roadmap and Ofgem's Project Discovery consider the relative costs, benefits and risks of different scenarios for achieving the de-carbonisation of electricity generation, so that there can be a transparent and well-informed debate on the relative merits and affordability to customers of the choices we are making.

Finally, on a more generic point, we consider that Ofgem and even the Authority should seek to engage more with the industry, particularly on issues which Ofgem wishes to manage within the competitive wholesale and retail markets. For example, we believe that there would be merit in the Ofgem CEO meeting collectively on perhaps a bi-annual basis with industry CEOs and the main industry Trade Associations, perhaps facilitated

by the UKBCSE. Such meetings would help maintain a productive relationship between Ofgem, key members of the industry and its representative bodies.

I hope you will find these comments helpful and we look forward to seeing the draft Ofgem Corporate Strategy later in the year. If you have any queries on this response, please do not hesitate to contact David Love or myself.

Yours sincerely

A handwritten signature in black ink, appearing to read "D. Linford".

**Denis Linford**  
Corporate Policy and Regulation Director